

# **Report of the auditor-general to Free State Legislature and the council on the Mantsopa Local Municipality**

## **Report on the financial statements**

### **Introduction**

1. I have audited the financial statements of the Mantsopa Local Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2016, the statement of financial performance, statement of changes in net assets, cash flow statement and the statement of comparison of budget and actual amounts for the year then ended, as well as the notes, comprising a summary of significant accounting policies and other explanatory information.

### **Accounting officer's responsibility for the financial statements**

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP), the requirements of the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA), the Division of Revenue Act, 2015 (Act No. 1 of 2015) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

### **Auditor-general's responsibility**

3. My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with the International Standards on Auditing. Those standards require that I comply with ethical requirements, and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

## **Basis for qualified opinion**

### Land

6. I was unable to obtain sufficient appropriate audit evidence that management had properly accounted for land due to the status of the accounting records and the non-submission of information in support of the basis for the value of land. In addition, land in the name of the municipality was incorrectly classified as investment property, land or inventory. I was unable to confirm land by alternative means. Consequently, I was unable to determine whether any adjustments to land stated at R348 583 035 (2015: R348 583 035) in note 4 to the financial statements, were necessary.

### Service charges

7. The municipality did not recognise revenue from exchange transactions in accordance with GRAP 9, *Revenue from exchange transactions*. Service charges were incorrectly calculated and levied on consumer accounts, which resulted in revenue from service charges and consumer debtors being understated by R104 293 372. In addition, I was unable to obtain sufficient appropriate audit evidence that the municipality had properly charged and accounted for income from service charges, due to the status of the accounting records. I was unable to confirm income from service charges by alternative means. Consequently, I was unable to determine whether any adjustment to service charges stated at R94 602 816 (2015: R87 747 924) in the financial statements, was necessary.

### Investment property

8. The municipality did not classify land held to earn rentals or for capital appreciation in accordance with GRAP 16 *Investment property*. Land in the municipality's name was not recognised as investment property. Consequently, investment property was understated by R41 715 603. Additionally, there was a resultant impact on land and inventory.

### Property rates

9. During 2015, I was unable to obtain sufficient appropriate audit evidence for property rates and to confirm the property rates by alternative means. Consequently, I was unable to determine whether any adjustment to property rates stated at R12 566 527, was necessary. My audit opinion on the financial statements for the period ended 30 June 2015 was modified accordingly. My opinion on the current period's financial statements was also modified because of the possible effect on this matter on the comparability of the current period's figures.

## Consumer debtors with credit balances

10. The municipality did not have adequate systems to maintain records of consumer debtors with credit balances. I could not confirm consumer debtors with credit balances by alternative means. Consequently, I was unable to determine whether any adjustments relating to the consumer debtors with credit balances stated at R6 962 693 in the financial statements, were necessary. Additionally, there was a resultant impact on consumer debtors from exchange and non-exchange transactions.

## Distribution losses

11. During 2015, I was unable to obtain sufficient appropriate audit evidence for water and electricity distribution losses and to confirm water and electricity distribution losses by alternative means. Consequently, I was unable to determine whether any adjustments to the distribution losses for water and electricity stated at R11 680 228, were necessary. My audit opinion on the financial statements for the period ended 30 June 2015 was modified accordingly. My opinion on the current period's financial statements was also modified because of the possible effect on this matter on the comparability of the current period's figures.

## Qualified opinion

12. In my opinion, except for the effects of the matters described in the basis for qualified opinion paragraphs, the financial statements present fairly, in all material respects, the financial position of the Mantsopa Local Municipality as at 30 June 2016 and its financial performance and cash flows for the year then ended, in accordance with the SA Standards of GRAP and the requirements of the MFMA and DoRA.

## Emphasis of matters

13. I draw attention to the matters below. My opinion is not modified in respect of these matters.

## Restatement of corresponding figures

14. As disclosed in note 41 to the financial statements, the corresponding figures for 30 June 2015 have been restated as a result of errors discovered during 2015-16 in the financial statements of the municipality at, and for the year ended, 30 June 2015.

## Material losses

15. As disclosed in note 52 to the financial statements, material electricity losses of R11 805 174 were incurred as a result of dissipation when electricity flows through the conductors, illegal connections, meter tampering and incorrect metering.

## Material impairments

16. As disclosed in note 11 to the financial statements, consumer debts from exchange transactions were impaired by R162 001 201 (2015: R160 841 729) and consumer debtors from non-exchange transactions were impaired by R15 563 880 (2015: R14 214 601).

## Irregular expenditure

17. As disclosed in note 47 to the financial statements, the municipality incurred irregular expenditure of R24 168 328 (2015: R32 029 652) during the year under review mainly due to non-compliance with supply chain management (SCM) requirements. In addition, the full extent of irregular expenditure was still being determined.

## Going concern

18. Note 44 to the financial statements indicates that the municipality's current liabilities exceeded its current assets by R32 344 521 (2015: R37 825 264). In addition, the municipality owed Eskom R63 777 928 (2015: R53 608 863) as at 30 June 2016, which was long overdue. These conditions, along with other matters as set forth in note 44, indicate the existence of a material uncertainty that may cast significant doubt on the municipality's ability to operate as a going concern and to meet its service delivery objectives.

## Unauthorised expenditure

19. As disclosed in note 45 to the financial statements, the municipality incurred unauthorised expenditure of R36 493 000 (2015: R131 838 000) during 2015-16 due to expenditure that exceeded the limits provided for in the main divisions of the approved budget.

## Additional matters

20. I draw attention to the matters below. My opinion is not modified in respect of these matters.

## Unaudited disclosure notes

21. In terms of section 125(2)(e) of the MFMA, the municipality is required to disclose particulars of non-compliance with the MFMA. This disclosure requirement did not form part of the audit of the financial statements and, accordingly, I do not express an opinion on it.

## Unaudited supplementary schedules

22. The supplementary information set out on pages XX to XX does not form part of the financial statements and is presented as additional information. I have not audited these schedules and, accordingly, I do not express an opinion on it.

## Report on other legal and regulatory requirements

23. In accordance with the Public Audit Act, 2004 (Act no. 25 of 2004) (PAA) and the general notice issued in terms thereof, I have a responsibility to report findings on the reported performance information against predetermined objectives for selected key performance areas presented in the annual performance report, compliance with legislation and internal control. The objective of my tests was to identify reportable findings as described under each subheading, but not to gather evidence to express assurance on these matters. Accordingly, I do not express an opinion or conclusion on these matters.

## **Predetermined objectives**

24. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected key performance area presented in the annual performance report of the municipality for the year ended 30 June 2016:
- Key performance area: Basic services community development and social cohesion, on pages xx to xx
25. I evaluated the usefulness of the reported performance information to determine whether it was consistent with the planned key performance area. I further performed tests to determine whether indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's Framework for Managing Programme Performance Information (FMPPI).
26. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
27. The material findings in respect of the selected key performance area are as follows:

## **Key performance area: Basic services community development and social cohesion**

### Usefulness of reported performance information

28. The FMPPI requires performance targets to be specific in clearly identifying the nature and required level of performance and be measurable. Important targets were not specific and measurable.
29. The FMPPI requires performance indicators to be well defined by having clear definitions so that data can be collected consistently and is easy to understand and use. A total of 48% of the indicators were not well defined.
30. The processes and systems that produced the indicator should be verifiable, as required by the FMPPI. A total of 52% of the indicators were not verifiable.

### Reliability of reported performance information

31. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure reliable reporting of actual achievements against planned objectives, indicators and targets. The reported performance information was not reliable when compared to the source information or evidence provided.

## **Additional matters**

32. I draw attention to the following matters:

### Achievement of planned targets

33. Refer to the annual performance report on pages x to x and x to x for information on the achievement of the planned targets for the year. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information for the selected key performance area reported in paragraphs x; x; x of this report.

### Unaudited supplementary schedules

34. The supplementary schedules set out on pages x to x does not form part of the annual performance report and is presented as additional information. I have not audited these schedules and, accordingly, I do not report on them.

## **Compliance with legislation**

35. I performed procedures to obtain evidence that the municipality had complied with applicable legislation regarding financial matters, financial management and other related matters. My material findings on compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PAA, are as follows:

## **Annual financial statements**

36. The financial statements submitted for auditing were not prepared, in all material respects, in accordance with the requirements of section 122 of the MFMA. Material misstatements of non-current assets, current assets, liabilities, expenditure and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected, but the uncorrected material misstatements and supporting records that could not be provided resulted in the financial statements receiving a qualified audit opinion.
37. The annual financial statements were not submitted for auditing within two months after the end of the financial year, as required by section 126(1)(a) of the MFMA.

## **Expenditure management**

38. I could not obtain sufficient appropriate audit evidence that money owed by the municipality had always been paid within 30 days, as required by section 65(2)(e) of the MFMA.
39. Reasonable steps were not taken to prevent unauthorised, irregular, fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.
40. An adequate management, accounting and information system was not in place which accounted for creditors, as required by section 65(2)(b) of the MFMA.

## **Revenue management**

41. An adequate management, accounting and information system which accounts for revenue, debtors and receipts of revenue was not in place, as required by section 64(2)(e) of the MFMA.
42. An effective system of internal control for debtors and revenue was not in place, as required by section 64(2)(f) of the MFMA.
43. Revenue due to the municipality was not calculated on a monthly basis, as required by section 64(2)(b) of the MFMA.



## **Asset management**

44. An adequate management, accounting and information system which accounts for assets was not in place, as required by section 63(2)(a) of the MFMA.
45. An effective system of internal control for assets was not in place, as required by section 63(2)(c) of the MFMA.
46. I could not obtain sufficient appropriate audit evidence that all investments were made in accordance with the requirements of the investment policy as the policy did not comply with the minimum requirements prescribed by the municipal investment regulation 3(3).

## **Liability management**

47. An adequate management, accounting and information system which accounts for liabilities was not in place, as required by section 63(2)(a) of the MFMA.
48. An effective system of internal control for liabilities (including a liability register) was not in place, as required by section 63(2)(c) of the MFMA.

## **Procurement and contract management**

49. Goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations, in contravention of SCM regulation 17(a) and (c).
50. Quotations were accepted from prospective providers who were not on the list of accredited prospective providers and did not meet the listing requirements prescribed by the SCM policy, in contravention of SCM regulations 16(b) and 17(b).
51. Goods and services with a transaction value above R200 000 were procured without inviting competitive bids, as required by SCM regulation 19(a). Deviations were approved by the accounting officer even though it was not impractical to invite competitive bids, in contravention of SCM regulation 36(1).
52. The preference point system was not applied in all procurement of goods and services above R30 000, as required by section 2(a) of the Preferential Procurement Policy Framework Act, 2000 (Act No. 5 of 2000) (PPPFA) and SCM regulation 28(1)(a).
53. Contracts were awarded to bidders who did not submit a declaration on whether they are employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c).
54. Construction contracts were awarded to contractors that did not qualify for the contract, in contravention of section 18(1) of the CIDB Act and CIDB regulations 17 and 25(7A).
55. Contracts were modified without tabling the reasons for the proposed amendment in the council of the municipality, as required by section 116(3) of the MFMA.



56. The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.

### **Internal control**

57. I considered internal control relevant to my audit of the financial statements, the annual performance report and compliance with legislation. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for qualified opinion, the findings on the annual performance report and the findings on compliance with legislation included in this report.

### **Leadership**

58. The leadership did not effectively oversee financial and performance reporting, compliance with legislation and the related internal controls as findings recurred in the year under review.
59. An audit action plan was developed to address internal and external audit findings, but implementation and adherence to the plan was not monitored by the appropriate level of management to improve the general control environment. This was mainly due to slow response by leadership as the recommendations made in the previous years were not prioritised for implementation.

### **Financial and performance management**

60. Ongoing monitoring and supervisory reviews over financial, performance and compliance reporting were not adequate. Internal control weaknesses were thus not identified and corrected in time to ensure accurate and complete reporting. Supervisory reviews over the work performed by consultants and implementation of daily and monthly disciplines were not adequate, resulting in material corrections to financial statements.

### **Governance**

61. The governance structures did not influence an improvement in the control environment of the local municipality which is mainly due to the fact that the audit committee was not appropriately constituted during the financial year.
62. The draft annual financial statements were not adequately reviewed by the audit committee, which resulted in material errors being identified in the annual financial statements submitted for auditing.

63. The implementation of recommendations made by the internal and external auditors based on findings raised in the year under review and previous year, respectively, were not adequately monitored by the audit committee. This resulted in the recurrence of the previous year's findings.

*Auditor-General*  
Bloemfontein

30 November 2016



**AUDITOR - GENERAL**  
**SOUTH AFRICA**

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